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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Simplification of the
Depreciation Prescription Process

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CC Docket No. 92-296

PETITION FOR RECONSIDERATION

John T. Lenahan
Barbara J. Kern

Attorneys for the Ameritech
Operating Companies

2000 W. Ameritech Center Dr.
4H88
Hoffman Estates, IL 60196-1025
(708) 248-6077

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SUMMARY

In this Petition, Ameritech requests that the Commission reconsider its decision to prescribe the basic factor range option as the depreciation process for local exchange carriers (LECs) regulated under price caps. In this regard, Ameritech demonstrates that there is insufficient justification for treating price cap LECs differently than AT&T. Therefore, the Commission should prescribe the price cap carrier option as the appropriate depreciation method for price cap LECs. Alternatively, if the Commission refuses to prescribe the price cap carrier option for price cap LECs, the Commission should maintain the current depreciation process with its current streamlined account procedures, because the basic factor range option does not simplify the depreciation process; rather it imposes significant additional administrative burdens on LECs.

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PETITION FOR RECONSIDERATION

The Ameritech Operating Companies (Ameritech),¹ pursuant to § 1.429 of the Federal Communications Commission's (Commission) rules, 47 C.F.R. § 1.429, respectfully submit this Petition For Reconsideration of the *Depreciation Simplification Order*.² In this Petition, Ameritech requests that the Commission reconsider its decision to prescribe the basic factor range option as the depreciation process for local exchange carriers (LECs) regulated under price caps. In this regard, Ameritech demonstrates that there is insufficient justification for treating price cap LECs differently than AT&T. Therefore, the Commission should prescribe the price cap carrier option as the appropriate depreciation method for price cap LECs. Alternatively, if the Commission refuses to prescribe the price cap carrier option for price cap LECs, the Commission should maintain the current depreciation process with its current streamlined account procedures, because the basic factor range option does not simplify the depreciation process; rather it imposes significant additional administrative burdens on LECs.

¹The Ameritech Operating Companies are: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Inc., Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

² Simplification of the Depreciation Process, CC Dkt. No. 92-296, FCC 93-452, 8 FCC Rcd. (released October 20, 1993) (*Depreciation Simplification Order*)

I. Introduction

On December 10, 1992, the Commission issued a Notice of Proposed Rulemaking seeking comment on four proposals to simplify the depreciation prescription process. In addition, the Commission sought comment on the treatment of future net salvage within the prescription process. There were substantial comments by numerous parties.

On October, 20, 1993, pursuant to the record developed in the proceeding, the Commission issued the *Depreciation Simplification Order*. In that Order, the Commission noted that it initiated the rulemaking to change the depreciation prescription process because developments in the telecommunications industry, i.e., the introduction of new technology, the implementation of price caps, and the increase in competition, made the current prescription process outdated. In this regard, the Commission stated that the goals of the rulemaking were to simplify the depreciation process, and provide administrative savings and flexibility, while continuing to ensure just and reasonable tariff rates.³ The Commission stated that it viewed its responsibility for regulatory oversight as a continuum going from strict regulatory oversight of depreciation rates for cost-plus carriers, to less regulatory oversight for price cap carriers subject to significant competitive pressures.⁴

Based on the goals of the rulemaking and the evidence in the record, the Commission adopted the modified form of the price cap carrier option for AT&T.⁵ Specifically, the Commission found that, since AT&T is regulated under

³ Id. at ¶ 3.

⁴ Id. at ¶ 5 and 19.

⁵ Under the price cap carrier option, carriers would file proposed depreciation rates with the Commission. Those rates would not be supplemented with supporting data; the Commission would propose to adopt the carriers' proposed rates and seek comment on their reasonableness. Prescription of the rates would be based on the proposed rates and any comments. Id. at ¶ 38.

price caps and does not have a sharing mechanism, it has no incentive to manage its earnings to avoid sharing with ratepayers. In addition, the Commission noted that since AT&T faced significant competition to its service offerings, it would have limited ability to adjust its prices to recover any added depreciation expenses. Therefore, the Commission found that AT&T should have the substantial flexibility provided under the price cap carrier option for determining depreciation rates. The Commission however modified the option to require AT&T to submit more information than originally proposed in the NPRM. The Commission noted that the additional information would assist it in monitoring the effectiveness of the price cap plan.⁶ And based on the additional information, the Commission concluded that it would have the information necessary to review AT&T's proposed depreciation rates for reasonableness.⁷

In contrast to the Commission's decision prescribing the price cap carrier option for AT&T, it prescribed a modified form of the basic factor range option for the price cap LECs as their depreciation method.⁸ The Commission found that, based on the LEC price cap regulatory scheme which includes a sharing adjustment and a rate of return back stop, price caps LECs had sufficient incentives to manage their earnings in order to avoid a sharing obligation or to place their earnings below the lower adjustment threshold. In addition, the Commission noted that price cap LECs were subject to only limited competitive

⁶ Id. at ¶¶ 91-94. In addition to the information AT&T would provide under the method described in the NPRM, under the modified plan, AT&T will have to provide generation data, a summary of the basic factors underlying the proposed depreciation rates by account, and a short narrative supporting the basic factors, including company plans of forecasted retirements and additions, and recent annual retirements, salvage and cost of removal.

⁷ Id. at ¶ 94.

⁸ Under the basic factor range option, the Commission would establish ranges for the basic factors that determine the parameters used in the depreciation rate formula: the FNS and the projection life. If the carrier used basic factors from within established ranges for a range account, that carrier would not be required to submit the detailed supporting data. Id. at ¶ 24.

pressures which therefore would not serve as an added check on their choices of depreciation rates. Thus, the Commission concluded that LECs should not have the additional flexibility afforded under the price cap carrier option for determining their depreciation rates. And, the Commission further noted that the additional regulatory scrutiny provided under the basic factor range option was necessary to ensure that LECs' depreciation rates were reasonable.⁹

Despite these findings, the Commission should reconsider its *Depreciation Simplification Order*. First, the modified price cap carrier option as described in the Order, together with the amount of competition faced by the price cap LECs, as well as the Commission's and other agencies' rules and regulations, ensure adequate regulatory oversight of depreciation expenses which in turn ensure reasonable depreciation rates. Second, the Commission has provided insufficient rationale justifying the disparate treatment between AT&T and the price cap LECs.

Alternatively, if the Commission does not find that the price cap carrier option should be applied to price cap LECs, the Commission should maintain the current depreciation process with its streamlined account procedures. As modified in the *Depreciation Simplification Order*, the basic factor range option actually imposes additional burdens on the price cap LECs as compared to the current depreciation prescription process.

II. The Commission Unreasonably Rejected the Price Cap Carrier Option for Price Cap Local Exchange Carriers.

In finding that the price cap carrier option would grant the LECs too much flexibility over their depreciation rates, the Commission relies on a theoretical argument that somehow price cap LECs will adjust their depreciation rates to manage their earnings levels in order to avoid the sharing mechanism, or to

⁹ *Id.* at ¶ 27-28.

bring their reported earnings below the lower adjustment threshold. In addition, the Commission concludes that the price cap LECs only face "emerging competition" and therefore should not be given the flexibility afforded under the price cap carrier option.¹⁰

However, the record does not support the Commission's theoretical argument. In this regard, the Commission gives too much weight to price cap LECs' sharing obligations. In doing so the Commission completely ignores the overarching incentive under the price cap regulatory system is to decrease costs. In this regard, price cap LECs are able to keep and retain higher profits **only** if they decrease costs and increase productivity. While the Commission seems convinced that price cap LECs will unreasonably increase depreciation expenses to avoid sharing with ratepayers, the Commission fails to balance that incentive with the incentives LECs have under price caps to report increased earnings to their shareholders.

Furthermore, in the *Depreciation Simplification Order*, the Commission focused on the state of competition in the telecommunications industry today, rather than recognizing that competition for access services is increasing significantly and will change dramatically in the next few months. In this regard, effective February 15, 1994, through the Commission's own action in the interconnection proceeding, LEC transport services for both special and switched access services will be competitive.¹¹ These orders permit competitive access providers (CAPs), interexchange carriers, and other interested parties to terminate their own special and switched access transmission facilities at LEC locations, including central offices, service wire centers, tandem switches, and

¹⁰ Depreciation Simplification Order at ¶ 44.

¹¹ Expanded Interconnection with Local Telephone Company Facilities, CC Dkt. No. 91-141, Transport, Phases I and II, FCC 93- 379, 8 FCC Rcd. (released September 2, 1993).

certain remote nodes. Consequently, as of February, 1994, LECs' interstate transport services -- a major portion of their interstate access services -- will be competing with the transport services of CAPs and facilities-based interexchange carriers both of which already own transport facilities.¹²

In addition to the growing competition for access services, there is growing competition for switching and local services as evidenced by the numerous announcements by cable companies, small interexchange carriers, and CAPs. For example, this paragraph lists just three of the most recent announcements which demonstrate the increasing competitive pressures facing LECs. On November 23, 1993, MCI announced that it will team with Jones Lightwave, Inc. and Scientific Atlanta to offer local and long distance telephone services, and cable TV service from a single source. The team will offer these services in Chicago, IL and Alexandria, VA.¹³ On November 12, 1993, MFS Communications Co. filed a request with the Illinois Commerce Commission to become a local exchange company in the Chicago area, competing with Illinois Bell. In November, 1993, Ameritech and Teleport Communications Group announced the near completion of a technical trial to demonstrate the feasibility of interconnecting their respective local switched telecommunications networks.

Thus, the Commission's conclusion that price cap LECs face only "emerging competition" is an unduly restricted view of the current marketplace, and will certainly not hold true in the next few years. Therefore, the

¹² Moreover, Attachments to Ameritech's Customers First Plan, filed with the Commission on April 1, 1993, include substantial information about the significant amount of competition and the number of competitors in metropolitan areas in Ameritech's region. This information, however, was collected prior to the full implementation of interconnection which, as noted above, will only increase competition in these service areas. See Supplemental Materials to Ameritech's Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Attachment 1 of 4, Volume 2, Appendix H, High Capacity Services in the Ameritech Region.

¹³ Telecommunications Reports, November 22, 1993, at p. 49.

Commission's prescription of the basic factor range option for price cap LECs at a time when these LECs will be facing as much as, if not more competition than AT&T, is not justified by the record in this proceeding.¹⁴

Likewise, the Commission failed to provide sufficient reasoning for its rejection of the fact that several additional factors will ensure that price caps LECs will report reasonable depreciation rates. Specifically, although the Commission admits that GAAP is an external control which places limits on the amount of depreciation expense, and concludes that GAAP may justify increased depreciation expense; the Commission fails to support with any explanation its conclusion that the increased expenses may not be "reasonable."¹⁵ Similarly, the Commission failed to address the fact that the rules and regulations established by the Securities and Exchange Commission which require an accurate reporting of the financial condition of a publicly held corporation also will serve to ensure reasonable depreciation rates.

The Commission also rejected, without sufficient grounds, the argument that the price cap carrier option would allow price cap LECs to record more accurate depreciation rates finding that price cap LECs control their depreciation rates already.¹⁶ The Commission stated that LECs control their depreciation rates through their deployment of new plant and the retirement of old plant on which the Commission bases its prescribed rates. However, that argument is disingenuous. In the first place, by definition, depreciation is the loss in **service**

¹⁴ In fact, despite competition being a factor in the Commission's decision not to prescribe the price cap option for LECs, there is nothing in the record in this proceeding regarding the competitive pressures facing price cap LECs. The Commission never requested, and was never provided, this type of information.

¹⁵ Depreciation Simplification Order at ¶ 46.

¹⁶ Id. at ¶ 52-53.

value of a capital asset over time¹⁷ and, therefore, the use of **retirement** of old plant (as opposed to an estimate of the remaining service value) is not a valid method of determining appropriate depreciation rates. In this regard, although certain plant equipment may not be retired because (for a number of reasons) only one circuit is activated, the productivity of that plant, i.e., the value of the service it provides, is essentially zero. Consequently, the Commission's use of mortality rates and plant retirements does not recognize the legitimate factors needed to determine accurate depreciation rates.

In the second place, the argument that LECs control their depreciation expense as advanced in the original price cap orders and repeated in this order is inherently inconsistent with the Commission's concern about giving LECs too much flexibility under the price cap carrier option. If LECs truly had control over their depreciation rates, as the Commission contends, then the Commission would not be concerned about granting them flexibility -- LECs would already have the flexibility the Commission now seeks to limit. Thus, the Commission should either give LECs control over their depreciation rates as it claims they already have and maintain endogenous treatment for changes in depreciation expenses, or admit that LECs have no such control and allow exogenous treatment for changes in depreciation expenses resulting from the Commission's change in the prescription of depreciation rates.

Finally, in the *Depreciation Simplification Order*, the Commission provided no explanation for its disparate treatment of AT&T and price cap LECs in prescribing depreciation rates. While the Commission expressly rejected any comparison between foreign entities' and cable companies' depreciation rates and price cap LECs' depreciation rates,¹⁸ the Commission remained

¹⁷ Louisiana Public Service Commission v. FCC, 476 U.S. 355, 364 (1986).

¹⁸ *Depreciation Simplification Order* at ¶ 51.

astonishingly silent on why AT&T -- which uses the same equipment as the LECs for similar services -- has significantly higher depreciation rates than LECs.¹⁹ That is because there is no justification. As described by the Commission, the modified price cap carrier option will provide sufficient information for the Commission to determine the reasonableness of AT&T's depreciation rates. While the Commission admits that regulatory oversight is necessary to ensure reasonable rates, it does not explain why the modified price cap formula does not provide sufficient regulatory oversight to ensure reasonable depreciation rates for price cap LECs as well.

Moreover, regardless of the differences between the regulatory systems applied to AT&T and price cap LECs, there is no justification for the Commission prescribing different projection lives for AT&T than for price cap LECs when both companies use the same equipment to provide similar services. Nevertheless, if the Commission is disinclined to prescribe the price cap carrier option for the price cap LECs, then at a minimum it should allow price cap LECs to transition, over a reasonable time period, their prescribed projection lives to the lower projection lives currently prescribed for AT&T.

Based on the foregoing, the Commission unreasonably rejected the price cap carrier option for the price cap LECs and should reconsider that decision.

III. The Basic Factor Range Option Provides No Simplification and Should Be Rejected.

The Commission prescribed the basic factor range option for price cap LECs, finding that it would provide simplification and administrative savings,

¹⁹ See e.g., BellSouth's Comment filed March 10, 1993 in this docket at p. 18. AT&T's lower projection lives also become apparent when comparing AT&T's prescribed projection lives for specific rate categories to the range of rates established in the Commission's recent order which would apply to LECs under the basic factor range option. In 7 of the rate categories, AT&T's prescribed projection lives are substantially lower than the established ranges.

while also providing sufficient oversight to ensure reasonable depreciation rates.²⁰ In this regard, the Commission states that, under the basic factor range option, price cap LECs could choose projection lives and future net salvage parameters within a reasonable range established by the Commission. The Commission notes, however, that price cap LECs must maintain the data supporting their choice within the range, although they are not required to submit that underlying data.²¹ For those accounts for which the price cap LEC's current prescribed parameters do not fall within the established ranges, the carrier must submit sufficient information to demonstrate that its basic factors should fall within the established ranges. Moreover, the Commission established the ranges to be +/- one standard deviation around an industry-mean of the basic factors underlying the currently prescribed depreciation rates.²²

Based on the Commission's method of establishing the ranges, and the means of implementing the basic factor range option, many price cap LECs will not experience any significant simplification of the depreciation process under the basic factor range option. In fact, initially and for the next several years over which the basic factor range will be implemented, many price cap LECs will experience additional administrative burdens by complying with the new depreciation prescription process.

With the range established at +/- one standard deviation, by definition one-third of the basic factors underlying the current depreciation rates will not fall within the range. And, since each account or rate category contains two basic

²⁰ Depreciation Simplification Order at ¶ 26.

²¹ Id. at ¶ 26 note 35.

²² Id. at ¶ 62. The Commission states that it may consider other factors such as the number of carriers with basic factors that fall within the initial range and future LEC plans in determining the actual range width for any one account.

factors for which ranges must be established, a LEC's chance of falling within both ranges and not being required to submit data becomes even smaller. For those LECs which do not fall within both ranges, they must "prove in" their ability to set their rates within the ranges through a comprehensive study, regardless of how much investment is in the account.

This basic factor range option contrasts significantly with the Commission's own streamlined study method established for minor rate categories. Specifically, under the streamlined study method, the Commission allows LECs to provide streamlined information if the account investment is equal to or less than 3 percent of the total study investment. Thus, the streamlined method substantially reduces the data analysis required for accounts in which the change in accrual will have little effect on the total change in the accounts. For example, the number of exhibits required under the streamlined method is approximately 13 for each rate category as compared to an average of 26 exhibits for each category for a full study.

Under the Commission's basic factor range option, when Illinois Bell Telephone Company submits information for its 1994 represcription, it will have to provide a full study for 21 rate categories. Specifically, of the 22 rate categories for which the Commission prescribed ranges in its most recent order,²³ Illinois Bell uses only 17 of those rate categories. Of those 17 categories, Illinois Bell currently prescribed projection lives and future net salvage values fall within only 9 of those ranges. Therefore, Illinois Bell must complete full studies for 8 of those rate categories in order to move their projection lives and future net salvage values into the ranges. Under the Commission's streamlined method, however, Illinois Bell would provide only streamlined information for those 8

²³ See Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, FCC 93-492, 8 FCC Rcd. (released November 12, 1993).

rate categories. This increase in required studies is a significant amount of work that would not have been required under the Commission's current depreciation prescription process.

In addition to the increased work required under the basic factor range option, the Commission's method of establishing the ranges is not reasonable. First, as noted above, limiting the range to +/- one standard deviation and thereby automatically excluding at least one-third of the basic factors makes the ranges too small to grant any flexibility to price cap LECs. In fact, several of the state commissions argued that the Commission must ensure that the established ranges were large enough to accommodate most of the already prescribed depreciation rates.²⁴ Moreover, those basic factors were determined to be "reasonable" under the prescriptions practices only two years earlier. Nevertheless, under the basic factor range option, it now appears that many of those basic factors become "unreasonable." In this regard, if a LEC has a rate category for which it used the streamlined method and which now falls below the established range, the LEC must submit a full cost study to either maintain its current depreciation rate, or have the factors come within the range and thereby decrease its depreciation expense.

Second, in establishing the ranges it appears that the Commission did not take into account the projection lives used by interexchange carriers, in particular those rates prescribed for AT&T, in its calculation of the industry mean. In this regard, since projection lives prescribed for AT&T are significantly lower than the projection lives prescribed for the price caps LECs, by not including the projection lives of the interexchange carriers in its calculation of the industry mean, the ranges established under the basic factor range option will result in

²⁴ Depreciation Simplification Order at ¶ 60.

projection lives that are higher than they would be otherwise. For example, in reviewing the ranges established by the Commission, AT&T's prescribed projection lives fall within only 3 of the established ranges. However, projection lives for 7 of AT&T's rate categories are already lower than the ranges established by the Commission. Again, since AT&T has the same equipment used for similar purposes, it is unjustifiable and arbitrary that the Commission prescribe such different projection lives.

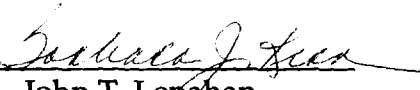
Based on the foregoing, the Commission's modified basic factor range option does not provide simplification and administrative savings to the price cap LECs. Since these are the goals of this rulemaking, the Commission should keep the current depreciation prescription process with its streamlined methodology, or establish ranges that accommodate more price cap LECs' prescribed basic factors and incorporate the basic factors used by the interexchange carriers.

IV. Conclusion

For the reasons set out in this Petition, Ameritech requests that the Commission reconsider its decision to prescribe the basic factor range option as the depreciation process for local exchange carriers (LECs) regulated under price caps. Rather, the Commission should prescribe the price cap carrier option as the appropriate depreciation process for price cap LECs. Alternatively, the Commission should maintain the current depreciation process with its streamlined methodology because the basic factor range option does not simplify

the depreciation process, but imposes significant additional administrative burdens on LECs.

Respectfully submitted,

By: 
John T. Lenahan
Barbara J. Kern

Attorneys for the Ameritech
Operating Companies

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